FINANCING WESTERN CITIES: Issues and Trends

INTRODUCTION

Due to urbanization and globalization, cities are clearly emerging as Canada's leading social and economic drivers. The vast majority of Canadians live in urban centres, with a full 55% living in cities with populations exceeding 100,000. Cities are economic hubs, and increasingly cities are taking an active role in economic development and growth. At the same time, municipalities are assuming greater responsibilities, moving beyond traditional urban issues such as policing and street services to meet broad community needs, such as services for the homeless and support for local arts and culture.

The growing importance of cities raises a number of significant questions. What are the current expenditure challenges facing municipalities? How are municipal revenue sources changing, and is this problematic for cities? Do municipalities have the fiscal resources necessary to fulfill their current roles and responsibilities?

Urban finance is an important issue for at least two reasons. First, because municipalities provide many of the core services upon which communities and businesses rely, the fiscal health of cities will have a long-term influence over the economies and quality of life in Canada's urban centres. Second, urban finance issues are strongly related to ongoing debates about tax cuts and service provision at the federal and provincial levels. As this discussion paper will demonstrate, choices made by senior governments have serious ramifications for municipalities. Given the growing importance of cities in Canada, discussions of federal and provincial policy need to evolve to factor in the impact upon cities. Overall, it is safe to argue that the financial security and viability of cities should be of concern to all citizens.

To increase public awareness of urban finance issues in western Canada, this discussion paper explores the current realities of the seven major western Canadian cities: Vancouver, Victoria, Calgary, Edmonton, Saskatoon, Regina and Winnipeg. The paper is informed by a survey of the seven City Manager offices, the emerging urban finance literature, and published municipal fiscal statistics. [1] This paper marks the start of a more in-depth Canada West Foundation exploration of municipal finance in the seven major western cities.

1. Only cities that granted permission to directly quote survey text are explicitly identified in the discussion. However, the information provided from all cities is fully reflected in the discussion of key issues.

This research report was authored by Canada West Foundation Director of Research Dr. Loleen Youngman Berdahl. Because of the independence given the author in writing this report, the opinions and recommendations expressed within are those of the author only, and do not necessarily reflect the opinions of the Canada West Foundation Council, its members, or donors.

CANADA WEST FOUNDATION

P.O. Box 6572 Station D Calgary, Alberta T2P 2E4
Tel: (403) 264-9535 Fax: (403) 269-4775 Website: www.cwf.ca

June 2000
ISBN# 1-895992-67-2

MUNICIPAL FINANCE:
The Basics

Today's municipal governments have numerous service and regulatory responsibilities ***(see Box 1)***. The expenditures necessary to meet these responsibilities are traditionally thought of as encompassing two categories – operating expenditures and capital expenditures.

a) ***Operating expenditures:*** This type of expenditure includes all costs related to the day-to-day operating of the city, such as the costs of providing policing and fire protection, regulating land use, animal control, and by-law enforcement.

b) ***Capital expenditures:*** These expenditures are traditionally related to long-term improvements in the city such as expanding public transit, building and improving roadways, constructing and upgrading public facilities, and even acquiring new land for the city.

As a city grows in size, increased demands are placed on both the operating and capital side of a municipal budget. The distinction between operating and capital expenditures relates back to the provincial legislation outlining the specific powers of municipalities. In all four western provinces, provincial legislation requires municipal governments to have balanced operating budgets. Thus, municipalities must be certain that they can collect sufficient revenues to pay their operating expenditures in a given fiscal year. [2]

Municipalities are also prohibited from borrowing money and assuming debt for operating expenditures. Depending on provincial legislation, municipalities are allowed to borrow funds for capital expenditures from either provincial financing corporations or independently. If a municipality does assume debt to fund a capital project, the payment of that debt and its interest comes from subsequent operating budgets.

2. If, despite budgeting, a municipality does have a deficit at year-end, the payment of this deficit is the first priority of the subsequent fiscal year.

BOX 1: Typical Responsibilities of Municipal Governments

Municipal governments have a number of service and regulatory responsibilities, many of which relate to servicing and protecting property. While some variations exist between and within provinces, municipal functions generally include:

- ***Police, fire and emergency services***
- ***Parks and recreation, public cultural facilities, public libraries***
- ***Roads and maintenance, lighting, traffic control, parking***
- ***Public transit***
- ***Water and sanitation (sewage and solid waste)***
- ***Garbage collection***
- ***Land-use planning (zoning) and regulation***
- ***Business regulation (licensing, permits, inspection)***
- ***Animal control and licensing***
- ***Economic development and promotion***
- ***Community and social development***

MAIN SOURCES OF MUNICIPAL REVENUES

1. Property Tax

Property tax refers to an annual tax on "real property" (land and its permanently attached items such as buildings), and represents the largest form of municipal tax revenue. The property tax rate (also known as the "mill rate") is applied to the assessed property value to determine the annual tax payable. Because it is assumed that the assessed value of one's property will increase as one's wealth increases, the property tax is sometimes argued as being a tax on wealth. However, some critics argue that the property tax is regressive in nature, as property will assume a large portion of a lower income family's wealth. [3] It should be noted that property tax rates are typically higher for business property than for residential property.

3. Harry Kitchen, among other urban economists, questions the validity of the "regressive property tax" argument. Research does not lead to a definitive conclusion on the question of regressivity.

While the property tax serves as an important revenue source for western municipalities, the tax does have its limitations. Perhaps most serious of these is the political difficulty in raising property tax rates. Because property tax is highly visible, increases in tax rates typically meet with high levels of public resistance. This is compounded by the fact that provinces use property tax to fund education, with municipalities collecting these educational property tax revenues on behalf of the provinces. Because many citizens may not recognize that property taxes support both municipalities and public education, public resistance to increased property tax may be partially related to a perception that municipalities collect greater property tax revenues than is actually the case. For this and other reasons, some municipal associations, such as the *Alberta Union of Municipal Associations (AUMA)*, argue that provinces should reduce their reliance upon property tax revenues for education funding. An additional problem with raising property tax is that it can lead to "suburban flight", as residents move outside the city to commuter areas with lower property tax rates, thus reducing the city's tax base. [4]

2. Business Tax

Businesses may be required to pay two forms of municipal taxes: property tax and business tax. The owner of the business property pays the property tax, while the occupant of the property pays the business tax *(Treff and Perry, 1998: 6:16)*. Thus, the same business property may be effectively taxed twice through taxes paid by the owner and the occupant. Business taxes are optional for many cities, but mandatory in Winnipeg due to provincial legislation.

3. User Fees

Municipalities employ user fees to collect revenues from specific services, such as sewage, water, parking, recreation and public transit. User fees serve not only as a revenue source, but also as a means to discourage inappropriate or wasteful usage of government services. In addition, user fees allow a municipality to collect revenue from non-residents who use its services. The challenge with user fees is establishing appropriate pricing. Economists argue that many public services are under-priced relative to their actual cost. Raising user fees can result in public outcry, as residents do not wish to give up subsidized golf courses and other services. Appropriately priced user fees also can limit the ability of lower-income residents to use public services. Finally, it is difficult to establish user fees for many municipal government services, such as policing or road maintenance *(Boadway and Kitchen, 1999: 410)*.

4. Intergovernmental Grants

Provincial governments provide the bulk of municipal grant revenues, while the federal government provides significantly lower funding. Intergovernmental grants to municipalities come in two forms *(Canadian Tax Foundation, 1992: 13:9-13:11)*. The first is specific purpose grants (or "conditional" grants) attached to specific projects. These grants are often in the form of matching grants, with the municipality required to provide a significant portion of the project revenue. Most provincial grants to municipalities are specific purpose grants. While these grants provide important revenues, one disadvantage with conditional grants is that they direct municipal spending and thus reduce the autonomy and flexibility of local governments. Conditional grants can also be risky for municipalities if sufficient guarantees are not in place to ensure grant transfers throughout the life of the project. The *Federation of Canadian Municipalities (FCM, 1998)* writes:

> *"The practices of provincial and federal governments terminating programs in mid-stream, often suddenly and with little, if any, consultation ... remains a continuing problem."* [5]

4. The issue of property taxes and suburban flight has been well documented in Winnipeg. For more on this issue, refer to Vander Ploeg et al., Issues 2000: Challenges on the Western Urban Landscape, Canada West Foundation, Calgary, Alberta, 2000.

5. The same arguments about the disadvantages of conditional grants are found in debates about federal transfers to the provinces. Provinces voice concern that funding will be cut, leaving the provinces with expensive programs to run. Provinces also express concern that the federal government uses its spending power to influence provincial policy decisions, thus undermining the autonomy of provincial governments.

The second form of grants are general purpose grants (or "unconditional" grants). Federal general purpose grants are provided in lieu of property tax.[6] Provincial general purpose grants include grants in lieu of property tax and other grants. (For example, Manitoba municipalities received a small share of provincial income tax revenues, distributed on a per capita basis.) The advantage of general purpose grants is that municipalities are able to use the revenues as they see fit. The majority of federal grants to municipalities are general purpose grants, whereas very few provincial grants fall into this category.

5. Borrowing and Debt

As noted earlier, municipalities can borrow for capital projects only. However, municipalities must be cautious to avoid high levels of debt accumulation. Because municipalities must pay debt through their operating budgets, and because municipalities are not allowed to borrow to pay for operating expenses, a city must be careful to ensure that its capital borrowing does not impinge upon its ability to meet all service needs and ensure debt repayment. In addition, a high debt load negatively impacts a city's bond rating, and therefore is a detriment to attracting investment.

6. Other

Other sources of revenue include development charges (in which developers are charged for some or all of the capital costs for services to new areas), licenses, investment income and frontage levies (e.g. charges to property owners for sidewalk repairs). It should also be noted that Vancouver has a gasoline tax.

The Canadian Constitution restricts provinces (and therefore municipalities, as provincially created entities) to direct taxation, including income, property and sale taxes. While it would not be unconstitutional for municipalities to collect sales and income taxes, these forms of revenue have not been available to municipalities since the 1940s due to provincial legislation ***(Perry, 1990: 221)***.

---

6. Property owned by federal and provincial governments (including crown corporations) is exempt from paying municipal property taxes. To compensate for this revenue loss, the senior governments provide grants-in-lieu of property taxes.

DISTINCTIONS BETWEEN MUNICIPAL, PROVINCIAL, AND FEDERAL FINANCE

There are two very important distinctions to draw between the financial realities and challenges facing municipalities and the challenges confronting the "senior" (federal and provincial) governments.

1. Revenue Sources

First, federal and provincial governments clearly have access to a greater variety of revenue sources. For example, federal government revenues include income tax, sales tax (Goods and Services Tax or GST), Employment Insurance (EI) and Canada Pension Plan (CPP) contributions, corporate tax, and a variety of duty and excise taxes, among others. Similarly, provincial governments have access to provincial income tax, sales tax, property tax, federal transfers, corporate tax, gasoline and tobacco tax, and gambling revenues, among others. The greater diversity of revenue sources, combined with the revenue-generating potential of these sources, is a significant fiscal advantage for Canada's senior governments.

2. Budget Deficits

The operating-capital distinction represents a second important difference between municipalities and the provincial and federal governments. While provincial and federal governments do make distinctions between the operating and capital side of their budgets, both have unrestricted access to borrowing for either forms of expenditure. Unlike municipal governments, provincial and federal governments are not prohibited from budgeting for deficits, as the deficit policy debates of the 1990s will attest. In other words, all three orders of government (federal, provincial and municipal) may have debt, but only federal and provincial governments can run deficits.

Overall, the differing revenue sources and guidelines for municipal and provincial and federal budgeting make it difficult to compare the "fiscal responsibility" of the different levels of government.

MUNICIPAL FINANCE IN CANADA: Trends and Issues

There are a number of fiscal challenges facing the seven major western Canadian cities. These challenges impact the seven cities to varying degrees, with some cities experiencing more significant fiscal pressures than others. These challenges can be divided into two main categories: pressures on municipal expenditures and changes in municipal revenue streams. Taken together, these two dynamics are creating significant pressures on municipal finance – pressures that can be expected to continue unless careful consideration is given to urban finance issues.

"While growth adds valuable human resources and business to Calgary, and increases the City's tax base, the growth has to be strategically managed. It requires infrastructure and service funding that exceeds the additional municipal property taxes generated. All these demands have financial impacts."

City of Calgary, CWF City Managers Survey 2000

1. Pressures on Municipal Expenditures

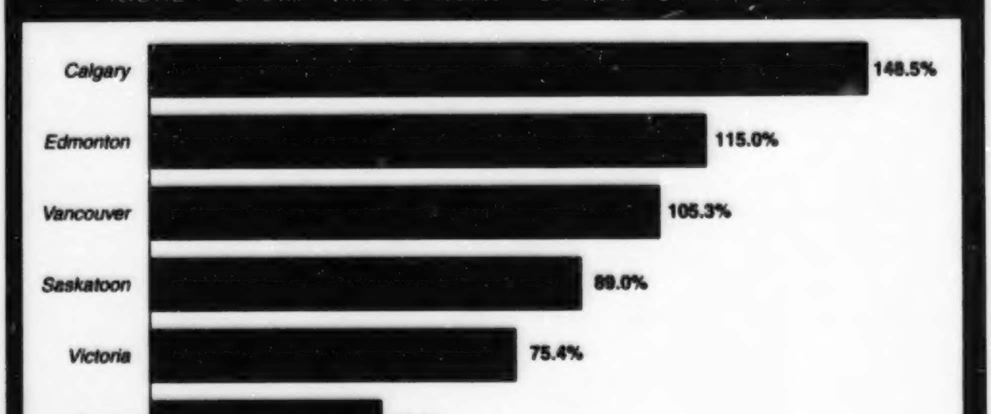
Our brief scan indicates that there are three key pressures currently being placed on the expenditure side of municipal budgets.

a) Urban Growth

Between 1966 and 1996, the seven western Census Metropolitan Areas (CMAs) combined experienced a 92% increase in population growth *(Vander Ploeg et al., 1999: 30)*. As ***Figure 1*** demonstrates, much of this growth was concentrated in the West's three largest cities – Calgary, Edmonton and Vancouver.

As cities grow, the population base obviously expands and new residential areas are developed. While urban growth is typically seen as an economic advantage, it also strains municipal expenditures as the expanded population increases the demands on existing infrastructure (leading to more rapid deterioration) and creates additional demand for new infrastructure. Thus, urban growth means expanded municipal capital expenditures for new roads, streetlights, schools, sewage and water lines, public libraries, recreational facilities, and transit lines. Urban growth also creates additional municipal operating expenditures in the form of increased service supply (e.g. garbage collection, use of water and sewage, expanded transit services).

FIGURE 1 Growth Rates of Western Canadian CMAs (1966 to 1996)



"While growth in the City always leads to increased demands for civic services and infrastructure, revenue increases tend to not keep pace with rising costs. This creates pressure to look for internal cost savings, consider tax increases or increase other revenues."

City of Edmonton, CWF City Managers Survey 2000

A particular problem associated with today's rapid urban growth is that such growth can place increased stress on a city's existing infrastructure and demand for new infrastructure without an accompanying growth in the city's property tax base to finance the new demand. This can occur because conceptually, today's modern cities are comprised of more than just the legal entity itself. For example, the City of Vancouver has a population of only 514,000, yet Vancouver is the heart of an urban area (or Census Metropolitan Area as defined by Statistics Canada) whose population exceeds 1.6 million. (The Vancouver CMA includes the City of Vancouver and 16 other surrounding municipalities.) If a significant portion of the Vancouver CMA's growth is occurring outside the City of Vancouver (in places such as Burnaby, Richmond, Surrey, Langely, etc.) the City of Vancouver itself will not benefit from the expanded property tax base. But, if the new residents work, shop and recreate within the City of Vancouver, they will obviously place demands on the city's infrastructure. Thus, Vancouver will have to bear many of the expenses associated with urban growth without enjoying all of the benefits that the growth brings. This is an issue that particularly affects Vancouver, Victoria, Edmonton and Winnipeg.

For many Canadian cities, this problem is becoming more acute. Since 1966, population distributions within Canadian CMAs have shifted considerably. Anchor cities are declining as a share of total CMA populations, while surrounding cities and rural fringes are seeing an increased share. While this trend indicates the growing reach of cities, it also presents the need for greater intergovernmental cooperation and even new financing arrangements *(Vander Ploeg et al., 1999: 44)*.

"We will continue to increase our contribution to capital works, but due to the size of the problem, we will require federal and provincial funding."

City of Saskatoon, CWF City Managers Survey 2000

b) Aging and Deteriorating Infrastructure

As *Almos Tassonyi (1997: 171)* notes:

> *"Infrastructure has become a very 'visible' problem, manifested by such developments as rising congestion on our highways, increasing numbers of portable classrooms and concerns over the supply of safe drinking water."*

Not surprisingly, repairing or replacing infrastructure is a highly expensive exercise. The *AUMA* estimates that Alberta municipalities face $355 million in annual unfunded infrastructure needs over the next five years. In addition, most of the major western Canadian cities identify infrastructure development or maintenance projects as priorities for the next few years. For example, the City of Edmonton reports:

> *"...given the existing policy and fiscal environment, the City of Edmonton could afford to finance either the rehabilitation of its existing infrastructure or the development of new infrastructure, but not both. In fact, given that particular sources of financing are only available for certain types of projects, the reality is that the City cannot afford to fully meet either its infrastructure rehabilitation or development requirements."*
>
> ***(City of Edmonton, 1998).***

The City of Edmonton predicts that its "infrastructure gap" will grow over the next ten years. In the survey responses, all the cities indicated the need to make strategic choices for infrastructure renewal. However, by putting off capital improvements, the long-term costs of infrastructure renewal may be greater. Thus, immediate fiscal realities limit a city's ability to meet its long-term infrastructure needs.

"With respect to capital projects, the number of projects to be done far exceeds the funding available so choices have to be made each year and inevitably some projects will be delayed... If adequate funding cannot be provided to sustain the City's assets, it will have long term implications on the ability of the city to sustain service levels. In addition, maintenance or capital costs will increase."

City of Calgary, CWF City Managers Survey 2000

"Council has eliminated lower priority capital projects, but does not delay or cut critical capital projects. Three year capital plans are developed and carried out. These plans ensure priority capital projects are undertaken in a timely manner."

City of Vancouver, CWF City Managers Survey 2000

BOX 2 Defining Infrastructure

The physical infrastructure of cities, just like municipal responsibilities, can differ depending on the jurisdiction. At the same time, municipal infrastructure is typically thought of as encompassing the following basics:

- *Roads, bridges and sidewalks*
- *Street lights*
- *Storm sewers*
- *Solid waste disposal and sewage treatment*
- *Water treatment and distribution*
- *Public transit systems*
- *Parks and recreation facilities*
- *Public library facilities*
- *Police and emergency response facilities*

"[In response to federal and provincial service cuts,] two different pressure points are observed: (1) housing demand for low income families is increasing with few opportunities to respond in ways to meet the need, [and] (2) applications for human service grants to non-profit and community organizations have increased over the last decade."

City of Regina, CWF City Managers Survey 2000

It should be noted that increasing infrastructure expenses are not limited to increased demands due to population growth and aging infrastructure. The purchase cost of infrastructure services provided by non-city organizations may also increase. For example, in 1999, the City of Vancouver reported that its sewage purchase costs had increased 13% above the 1998 levels. (The Greater Vancouver Sewer and Drainage District establishes sewage prices.) This large increase has had a significant impact on that city's budgeting.

c) Off-Loading from Senior Governments

In their efforts to decrease spending and achieve balanced budgets, many senior governments cut services in the 1990s. This can create challenges for municipal governments in at least two ways. The first is that municipal governments can face significant public pressure to assume these responsibilities. Thus, we see municipal governments becoming highly involved in dealing with issues of homelessness and other social services, and working to promote economic growth and development. These new responsibilities are not accompanied by increased funding. Second, if a senior government reduces or eliminates specific purpose grants, the affected municipality may be left with full financial responsibility for a large project. The *Federation of Canadian Municipalities (1998)* writes:

> *"It has become common for the federal government to place increased financial pressure on municipal governments. Examples include the offloading of federally-owned and subsidized airports, marine ports and fishing harbours onto communities, the elimination of funding for new social housing, and increased costs to municipal governments and provinces for RCMP services."*

In short, the federal and provincial governments' efforts to balance their budgets are often achieved at the expense of municipalities.

"In the last couple years, the City has begun to fund emergency shelter and transitional housing projects such as the Salvation Army and the Calgary Drop-In Centre. Prior to senior government cutbacks, these capital dollars would have been provided by the federal and provincial governments for such projects. The City is now expending significant dollars in an area that was historically a senior government responsibility."

City of Calgary, CWF City Managers Survey 2000

One notable exception to this downloading trend is the City of Winnipeg. In 1999, the city transferred its public health services and social services programs to the province of Manitoba. The result has been a decrease in both expenditures and revenues for the city – essentially a cost-neutral transfer.

Despite these significant expenditure challenges, the cities report that their expenditures have remained relatively stable over the past ten years, generally keeping at or under inflationary rates. Internal cost reductions and streamlining, and the delaying of capital projects have achieved this expenditure stability. However, the fact that cities have been able to cope with many challenges and fewer resources does not imply that the current situation is optimal for their long-term fiscal health.

"The major cuts occurred in 1997 when the grants received by the city from the Provincial Revenue Sharing Grant program ($15M) and the Federal Canada Assistance Plan program ($2M) were reduced by $17 million... Council used a combination of increased user charges, a small amount of expenditure reductions and a large (4.5%) tax increase to deal with the revenue shortfall. With this solution, Council avoided any significant cuts in program areas."

City of Vancouver, CWF City Managers Survey 2000

2. Changes in Municipal Revenue Streams

Over the past decade, municipal governments in Western Canada have witnessed numerous changes in their revenue streams. Some of these, such as changes in senior government granting, are choices made outside the municipal governments. Other changes, such as an increased reliance on property tax, user fees and borrowing, reflect current choices and strategies devised by municipal governments themselves.

a) Decreased Grant Funding

"From 1992 to 1999, operating grants were reduced from $55 million to just over $21 million... Unconditional grants decreased from $48 million in 1992 to $17 million in 1999. The ongoing basic grant for capital went from $70 per capita prior to 1992 to $25 in 1993."

City of Edmonton, CWF City Managers Survey 2000

The most dramatic shift in municipal revenues has been the decreased grant funding provided by senior governments. In the deficit reduction climate of the 1990s, municipal governments faced significant cuts in their intergovernmental transfers. For example, in 1992, in the attempt to reduce its deficit, the federal government froze federal payments of grants-in-lieu of property tax, representing an annual loss of appropriately $600 million for Canadian municipalities *(FCM, 1998)*. This unilaterally imposed grant freeze has since ended, but it does demonstrate the instability of grant funding for municipal governments. Grant cuts are not limited to the federal level. To provide but one example, City of Vancouver documents *(1997, 1999)* indicate that the British Columbia government cut back its total funding to the city by $17.2 million in 1997, and eliminated the Equalization Grant Program, which represented a loss of almost $6 million for Vancouver in 1999.

Grant cuts have significantly impacted the revenues of municipalities. The City of Saskatoon's 1998 Financial Report reveals that transfer revenues from other governments dropped $5.3 million between 1994 and 1998. Most other cities report similar decreases. Taken in the context of increasing expenditures, the cuts present a formidable challenge to municipal finances.

"Since 1990, the grants provided to the City by other levels of government have declined significantly. For example, grants provided by the Province of Saskatchewan in 1990 totaled $19,094,600 while in 2000 they are expected to be $8,058,000, a decrease of 57%."

City of Regina, CWF City Managers Survey 2000

In recent years, there have been some increases in municipal granting as provincial governments saw improved budgets and came under increased pressure from municipal leaders. The Alberta government increased the municipal transportation grant by $121 million in 1999, while in the same year the British Columbia government announced a program to share traffic fine revenues with municipalities. There are, however, two unanswered questions: does this represent a trend shifting away from senior government grant cuts, and will new grants be sufficient to cover the losses of prior cuts and emerging municipal expenditure needs?

TABLE 1: Changes in Municipal Revenue Streams (1980 to 1993)

	Municipal Property Taxes			User Fees			Conditional Grants			Unconditional Grants		
	[illegible]	[illegible]	[illegible]	1980	1986	1993	[illegible]	[illegible]	[illegible]	1980	1986	1993
Manitoba	38.6%	38.5%	36.8%	12.9%	15.5%	16.5%	20.8%	21.5%	25.5%	14.1%	11.3%	10.9%
Saskatchewan	29.7%	22.8%	30.8%	16.0%	18.7%	19.6%	29.8%	33.0%	28.7%	11.8%	12.1%	10.0%
Alberta	17.2%	22.8%	23.7%	27.3%	20.8%	23.8%	33.8%	37.6%	31.7%	8.0%	5.3%	6.5%
British Columbia	39.5%	41.8%	38.8%	24.7%	21.0%	24.5%	14.4%	16.5%	18.8%	12.6%	7.4%	6.0%
CANADA	38.1%	37.1%	38.1%	17.9%	19.2%	19.3%	23.6%	24.5%	27.9%	12.0%	9.5%	8.1%

b) A Shift Toward Conditional Grants

As ***Table 1*** demonstrates, between 1980 and 1993, unconditional grants (as a percentage of total municipal revenues) decreased nationally, while the percentage share of conditional grants increased. This national pattern held true for Manitoba and British Columbia, while Alberta and Saskatchewan municipalities experienced decreases in both conditional and unconditional grants. As noted earlier, conditional grants reduce the autonomy of municipal governments, as they allow senior governments to influence municipal expenditure decisions. It is important to note that this shift toward increased conditional grants for municipalities runs contrary to recent changes in the federal-provincial granting environment as seen through the Canada Health and Social Transfer. With this change, the federal government effectively reduced the number of conditions on its transfers to provinces in the 1990s.

Not surprisingly, provincial urban municipalities associations voice preferences for stable unconditional funding. The *Saskatchewan Urban Municipalities Association (SUMA, 1999)* writes that:

> *"Saskatchewan's urban governments are looking for greater stability in provincial funding transfers to municipalities, which have been cut in half during the last decade. Based on this experience, cities are now looking for provincial assistance largely for the purpose of infrastructure renewal.... SUMA has long favoured unconditional grant funding combined with some conditional assistance targeted to particular needs or a more generalized equalization of fiscal resources among municipalities."*

c) Increased Reliance on Property Tax Revenue

In response to declining government grants and new expenditures demands, many municipalities have focused on increasing their "own-source" revenues. At the top of this list is property taxes, and many western cities have raised their mill rates to generate more revenue. Regina, Calgary, and Edmonton have all proposed to raise mill rates for their 2000 budgets. Increased property tax rates are also being used in smaller municipalities – a recent study by the *AUMA* reports that 15 of 16 "major [Alberta] centres" plan to increase property taxes in 2000 *(AUMA 2000)*. In the Canada West Foundation City Managers survey, most cities reported that increases have been kept to the rate of inflation, and that strategies are in place to maintain mill rates at or below inflation.

Clearly, as city governments are aware, increased property tax revenues alone are not a complete answer to revenue needs. First, as noted earlier, raising property rates above those of adjacent areas can lead to "suburban flight", thus reducing the city's tax base. Second, there is significant public resistance to tax increases of any kind, making this a politically unattractive option. One alternative to sidestep these limitations has been proposed by the *AUMA*, which has argued for a decrease in the provincial property tax "take." *AUMA* President Lorne Olsvik states:

> *"Freezing and then reducing the $1.3 billion in [Alberta] provincial property taxes would allow municipalities to deal with the growth pressures on local services without increasing Alberta's overall tax burden."* ***(AUMA 2000).***

TABLE 1: Changes in Municipal Revenue Streams (1980 to 1993)
(Presented as a percentage of total municipal revenues by province)

	Municipal Property Taxes			User Fees			Conditional Grants			Unconditional Grants		
	1980	1986	1993	1980	1986	1993	1980	1986	1993	1980	1986	1993
Manitoba	38.6%	36.5%	36.8%	12.9%	15.5%	16.5%	20.8%	21.5%	25.5%	14.1%	11.3%	10.9%
Saskatchewan	29.7%	22.6%	30.5%	16.0%	18.7%	19.6%	29.8%	33.0%	28.7%	11.8%	12.1%	10.0%
Alberta	17.2%	22.8%	23.7%	27.3%	20.8%	23.8%	33.8%	37.6%	31.7%	8.0%	5.3%	6.5%
British Columbia	33.5%	41.8%	38.5%	24.7%	21.0%	24.5%	14.4%	16.5%	16.8%	12.6%	7.4%	6.0%
CANADA	36.1%	37.1%	36.1%	17.9%	19.2%	19.3%	23.6%	24.5%	27.9%	12.0%	9.5%	8.1%

SOURCE [illegible]

b) A Shift Toward Conditional Grants

As *Table 1* demonstrates, between 1980 and 1993, unconditional grants (as a percentage of total municipal revenues) decreased nationally, while the percentage share of conditional grants increased. This national pattern held true for Manitoba and British Columbia, while Alberta and Saskatchewan municipalities experienced decreases in both conditional and unconditional grants. As noted earlier, conditional grants reduce the autonomy of municipal governments, as they allow senior governments to influence municipal expenditure decisions. It is important to note that this shift toward increased conditional grants for municipalities runs contrary to recent changes in the federal-provincial granting environment as seen through the Canada Health and Social Transfer. With this change, the federal government effectively reduced the number of conditions on its transfers to provinces in the 1990s.

Not surprisingly, provincial urban municipalities associations voice preferences for stable unconditional funding. The *Saskatchewan Urban Municipalities Association (SUMA, 1999)* writes that:

> *"Saskatchewan's urban governments are looking for greater stability in provincial funding transfers to municipalities, which have been cut in half during the last decade. Based on this experience, cities are now looking for provincial assistance largely for the purpose of infrastructure renewal.... SUMA has long favoured unconditional grant funding combined with some conditional assistance targeted to particular needs or a more generalized equalization of fiscal resources among municipalities."*

c) Increased Reliance on Property Tax Revenue

In response to declining government grants and new expenditures demands, many municipalities have focused on increasing their "own-source" revenues. At the top of this list is property taxes, and many western cities have raised their mill rates to generate more revenue. Regina, Calgary, and Edmonton have all proposed to raise mill rates for their 2000 budgets. Increased property tax rates are also being used in smaller municipalities – a recent study by the *AUMA* reports that 15 of 16 "major [Alberta] centres" plan to increase property taxes in 2000 *(AUMA 2000)*. In the Canada West Foundation City Managers survey, most cities reported that increases have been kept to the rate of inflation, and that strategies are in place to maintain mill rates at or below inflation.

Clearly, as city governments are aware, increased property tax revenues alone are not a complete answer to revenue needs. First, as noted earlier, raising property rates above those of adjacent areas can lead to "suburban flight", thus reducing the city's tax base. Second, there is significant public resistance to tax increases of any kind, making this a politically unattractive option. One alternative to sidestep these limitations has been proposed by the *AUMA*, which has argued for a decrease in the provincial property tax "take." *AUMA* President Lorne Olsvik states:

> *"Freezing and then reducing the $1.3 billion in [Alberta] provincial property taxes would allow municipalities to deal with the growth pressures on local services without increasing Alberta's overall tax burden."* **(AUMA 2000).**

Similarly, the *SUMA (1999)* writes:

> *"A crucial element in the fiscal health of municipalities is achieving more secure (if not exclusive) access to the local property tax base to fund municipal services."*

SUMA also notes that high education property taxes are creating a "property tax revolt" in rural Saskatchewan. This rural resistance further suggests that the urban municipalities have limited room within which to increase property taxes.

d) Increased Reliance on User Fees

Many municipalities are viewing increased user fee revenues as an important strategy for meeting budgetary needs. Urban economists argue that many municipal services are under-priced, resulting in significant municipal government subsidizing of services. For example, city golf course green fees are often considerably lower than private sector courses, and city transit fees rarely cover the costs of service provision. The current fiscal climate has forced some municipalities to re-adjust numerous user fees to appropriate levels, and to consider user fees for a wider variety of services. Most cities report that user fee increases, when applied, will be targeted to remain at or under inflationary rates.

There is reason to assume that increased user fees will be a municipal reality in years ahead, and that municipalities may begin to explore options for new user fees. Economist *Harry Kitchen (1997)* notes that user fees might be considered for garbage collection and disposal, fire services and even some police services.

e) Municipal Debt Avoidance and Reduction

Despite the need for infrastructure renewal (recall that capital expenditures may be funded by borrowing), municipalities are generally avoiding assuming debt to fund projects. Where debt is unavoidable, many municipal governments attempt to minimize the amount borrowed. In addition to avoiding debt accumulation, some municipalities are aggressively working to pay off existing debts. For example, the City of Calgary has adopted "a corporate policy of significant capital debt reduction, with no new borrowing permitted for tax supported capital projects," (*City of Calgary, 1998: 9*).

To reduce borrowing, municipal governments will often adopt "pay-as-you-go" financing strategies. These are often coupled with efforts to restore rather than replace aging infrastructure, and in some cases, simply "going without." Economist *Almos Tassonyi (1997: 183)* states that while the municipal debt avoidance or pay-as-you-go strategy is appropriate for certain infrastructure projects, it is not universally appropriate:

> *"The pay-as-you-go approach can be deleterious over the long run... if maintenance and replacement are perpetually postponed for lack of revenue or political will. Also, it can be argued that borrowing over a period is a more appropriate way to finance large scale capital projects. Since it is unlikely that sufficient funds have been previously accumulated to avoid significant tax or fee increases, borrowing allows the impact on ratepayers and beneficiaries to be smoothed out. Depending on the trend in real interest rates, borrowing can also be financially advantageous."*

Thus, fiscal prudence does not always necessitate the elimination of municipal borrowing.

"Increases in user fee revenues come mainly from growth in the number of customers rather than increasing rates. In general, rate increases have been at or below inflation levels except for private goods where markets set the price or user pay is clearly the right way to go."

City of Calgary, CWF City Managers Survey 2000

"User fees are a good source of revenue and should reduce funding reliance on the mill rate."

City of Saskatoon, CWF City Managers Survey 2000

"The City has increased the use of user fees in the last number of years. Depending on the service, user fees are maintained at cost recovery or market levels, not for increased revenue."

City of Vancouver, CWF City Managers Survey 2000

MUNICIPAL FINANCE CHALLENGES: A Bondrater's View

A window on the fiscal issues facing several Western Canadian cities is provided by the *Dominion Bond Rating Service (DBRS)* and the *Canadian Bond Rating Service* which issue reports for several cities. Listed below are the primary challenges, as identified by the DBRS, facing four cities (Vancouver, Calgary, Edmonton and Winnipeg).

1. Vancouver

The DBRS notes that Vancouver faces a number of challenges including union negotiations, increasing Greater Vancouver Sewage and Drainage District requisitions, and the establishment of an emergency communications system. The DBRS adds:

> *"These pressures, plus the potential downloading of responsibilities from the Province, suggest that the City may have difficulty maintaining its property tax increases below the rate of inflation."*
>
> ***(DBRS Press Release, December 22, 1999.)***

2. Calgary

The DBRS reports that one of the most significant challenge facing Calgary is its rapid pace of population growth and the expenditure implications that this carries in its wake:

> *"The major challenge facing the City is its ability to manage and finance the large operating and capital expenditures required to service its rapidly growing population without placing excessive pressure on either debt levels or property taxes. While Calgary has seen a significant decline in its tax-supported debt over the last ten years, the level still remains high and, consequently, has resulted in high debt servicing costs. Future capital expenditures will slow the pace of debt reduction, and operating expenditure requirements will put pressure on the City's operating balance."*
>
> ***(DBRS Press Release, March 9, 1999.)***

3. Edmonton

In its report on Edmonton, the DBRS points to concerns over weak growth in the municipal tax base and increasing expenditures on both the operating and capital side of the municipal budget:

> *"The two main challenges facing the city are its weak taxable assessment growth, which has limited the growth in the city's tax revenues, and a high level of self-supporting debt, primarily debt issued on behalf of EPCOR Utilities... Continued weak taxable assessment growth and, consequently, weak tax revenue growth could pose a challenge to the City's finances as it continues to face increasing operating and capital expenditure pressures, and has little room to further rationalize services and eliminate inefficiencies."*
>
> ***(DBRS Press Release, July 21, 1999.)***

4. Winnipeg

The DBRS notes the following challenges facing Manitoba's key urban centre:

> *"A high tax burden relative to surrounding municipalities; a high level of tax-supported debt; and a significant infrastructure deficit The high tax burden has contributed to the decline in population as Winnipeg residents have moved to outside municipalities that have lower property taxes. Continued declines in the population will limit economic growth and revenue growth, and could place pressure on Winnipeg's finances... [T]he City will have to deal with its significant infrastructure deficit. This will pose a major financial challenge given the already high tax and debt burdens."*
>
> ***(DBRS Press Release, June 17, 1999.)***

TABLE 2 Bond Ratings of Western Canadian Cities

	Dominion Bond Rating Service (DBRS)	Canadian Bond Rating Service (CBRS)
Calgary	AA	No Rating Provided
Edmonton	AA (High)	AA –
Regina	No Rating Provided	AA +
Saskatoon	No Rating Provided	AAA
Vancouver	AAA	No Rating Provided
Victoria	No Rating Provided	No Rating Provided
Winnipeg	AA (Low)	A +

MUNICIPAL FINANCE CHALLENGES: A Bondrater's View

A window on the fiscal issues facing several Western Canadian cities is provided by the *Dominion Bond Rating Service (DBRS)* and the *Canadian Bond Rating Service* which issue reports for several cities. Listed below are the primary challenges, as identified by the DBRS, facing four cities (Vancouver, Calgary, Edmonton and Winnipeg).

1. Vancouver

The DBRS notes that Vancouver faces a number of challenges including union negotiations, increasing Greater Vancouver Sewage and Drainage District requisitions, and the establishment of an emergency communications system. The DBRS adds:

> *"These pressures, plus the potential downloading of responsibilities from the Province, suggest that the City may have difficulty maintaining its property tax increases below the rate of inflation."*
>
> ***(DBRS Press Release, December 22, 1999.)***

2. Calgary

The DBRS reports that one of the most significant challenge facing Calgary is its rapid pace of population growth and the expenditure implications that this carries in its wake:

> *"The major challenge facing the City is its ability to manage and finance the large operating and capital expenditures required to service its rapidly growing population without placing excessive pressure on either debt levels or property taxes. While Calgary has seen a significant decline in its tax-supported debt over the last ten years, the level still remains high and, consequently, has resulted in high debt servicing costs. Future capital expenditures will slow the pace of debt reduction, and operating expenditure requirements will put pressure on the City's operating balance."*
>
> ***(DBRS Press Release, March 9, 1999.)***

3. Edmonton

In its report on Edmonton, the DBRS points to concerns over weak growth in the municipal tax base and increasing expenditures on both the operating and capital side of the municipal budget:

> *"The two main challenges facing the city are its weak taxable assessment growth, which has limited the growth in the city's tax revenues, and a high level of self-supporting debt, primarily debt issued on behalf of EPCOR Utilities... Continued weak taxable assessment growth and, consequently, weak tax revenue growth could pose a challenge to the City's finances as it continues to face increasing operating and capital expenditure pressures, and has little room to further rationalize services and eliminate inefficiencies."*
>
> ***(DBRS Press Release, July 21, 1999.)***

4. Winnipeg

The DBRS notes the following challenges facing Manitoba's key urban centre:

> *"A high tax burden relative to surrounding municipalities; a high level of tax-supported debt; and a significant infrastructure deficit. The high tax burden has contributed to the decline in population as Winnipeg residents have moved to outside municipalities that have lower property taxes. Continued declines in the population will limit economic growth and revenue growth, and could place pressure on Winnipeg's finances... [T]he City will have to deal with its significant infrastructure deficit. This will pose a major financial challenge given the already high tax and debt burdens."*
>
> ***(DBRS Press Release, June 17, 1999.)***

TABLE 2: Bond Ratings of Western Canadian Cities

	Dominion Bond Rating Service (DBRS)	Canadian Bond Rating Service (CBRS)
Calgary	**AA**	**No Rating Provided**
Edmonton	AA (High)	AA –
Regina	**No Rating Provided**	**AA +**
Saskatoon	No Rating Provided	AAA
Vancouver	**AAA**	**No Rating Provided**
Victoria	No Rating Provided	No Rating Provided
Winnipeg	**AA (Low)**	**A +**

SOURCE

NOTE

THE COMBINED IMPACT OF GROWING EXPENDITURES AND CHANGING REVENUE SOURCES

On both the expenditure and revenue side, municipal governments are clearly feeling budgetary pressures. Fiscal concerns are a serious limitation on the ability of municipal governments to meet the needs of their residents. *SUMA (1999)* argues, "Most of the challenges facing urban municipalities are connected to revenue generation and expenditure management." Understanding the fiscal restraints requires considering the combination of expenditure and revenue pressures. *Kitchen (1997: 135, 164)* writes,

> *"[T]he combination of reduced provincial/territorial grant funding and downloading of various expenditure responsibilities to municipalities has increased pressures on the local revenue base...Over the past few years, the provincial practice of reducing unconditional grants and downloading more and more expenditure responsibilities to local governments has created a fiscal environment in which municipalities are becoming more dependent on local property taxes and user fees. Furthermore, the fiscal reality in which federal and provincial governments currently operate suggests that municipalities will have to become even more self-reliant."*

Perhaps the greatest challenge for municipal governments is to find the means to be self-reliant while maintaining public support. To do so may require a broader reconsideration of the responsibilities and revenue sources for all three orders of government.

CONCLUSIONS

The future path for the financing of Western Canadian cities is unclear, but what is certain is that the matter does require increased public and policymaker attention and research of the available options. Because cities will continue to act as key social hubs and global economic drivers in the years ahead, urban finance issues will grow increasingly important. For cities to ensure that the needs of their residents and their economies are met, they must have access to sufficient and stable revenues. To achieve this, policy debates must move beyond questions of fiscal transfers (how much, conditional versus unconditional) to explore the more fundamental issues of the appropriate forms of revenue generation for cities. Topics that have been raised for research and consideration include providing municipalities access to revenues from sales and fuel taxes, vehicle charges for roadways, reconsidering the role of property tax in the funding of education, and an increased voice for municipalities in provincial decisions that directly impact the cities.

BIBLIOGRAPHY

Alberta Urban Municipalities Association. (undated). Municipal Finance Business Plan. See *http://www.auma.ab.ca/main/home.htm*

Alberta Urban Municipalities Association. (2000). "Property Taxes Up for Most Albertans." News Release February 23, 2000. See *http://www.munilink.net/main/sub3/past_nz/022300NR.htm*

Boadway, Robin and Kitchen, Harry. (1999). Canadian Tax Policy, Third Edition. Canada: Canadian Tax Foundation.

City of Calgary (1998). A Report to Citizens 1998. See *www.gov.calgary.ab.ca*

City of Edmonton. (1998). Edmonton's Infrastructure Strategy. Presented to City Council June 2, 1998.

City of Vancouver (1997). Vancouver City Choices. See *http://www.city.vancouver.bc.ca/ctyclerk/citychoices/intro.htm*

City of Vancouver (1999). Administrative Report, Standing Committee on City Services and Budgets. April 21, 1999. See *http://www.city.vancouver.bc.ca/ctyclerk/cclerk/990429/csb7.htm*

Dominion Bond Rating Service, Press Releases, dated March 9, 1999, June 17, 1999, July 21, 1999, and December 22, 1999. See *www.dbrs.com.*

Federation of Canadian Municipalities. (1998). 1998 Policy Statement on Municipal Finance. See *http://www.fcm.ca/english/national/finance/finance.html*

Kitchen, Harry. (1997). "Pricing of Local Government Services." In Paul H.R. Hobson and France St-Hilaire (eds.). Urban Government and Finance: A Question of Who Does What. Canada: Institute for Public Policy, pp. 135 – 168.

Perry, J. Harvey. (1990). Taxation in Canada (Fifth Edition). Canada: Canadian Tax Foundation.

Sancton, Andrew. (1994). Governing Canada's City Regions: Adapting Form to Function. Canada: Institute for Public Policy.

Saskatchewan Urban Municipalities Association (1999). SUMA Submission to the Task Force on Municipal Legislative Renewal. See *http://www.suma.org/policy/publications/taskforce99.htm*

Tassonyi, Almos. (1997). "Financing Municipal Infrastructure in Canada's City-Regions." In Paul H.R. Hobson and France St-Hilaire (eds.). Urban Government and Finance: A Question of Who Does What. Canada: Institute for Public Policy, pp. 171-204.

Treff, Karin, and Perry, David B. (1998). Finances of the Nation 1998. Canada: Canadian Tax Foundation.

Vander Ploeg, Casey, Youngman Berdahl, Loleen and Gibbins, Roger. (1999). Cities@2000: Canada's Urban Landscape. Calgary: Canada West Foundation (1999).

Vander Ploeg, Casey, Blackett, Glenn, and Bates, Michael (2000). Issues 2000: Challenges on the Western Urban Landscape. Calgary: Canada West Foundation (2000).

THE COMBINED IMPACT OF GROWING EXPENDITURES AND CHANGING REVENUE SOURCES

On both the expenditure and revenue side, municipal governments are clearly feeling budgetary pressures. Fiscal concerns are a serious limitation on the ability of municipal governments to meet the needs of their residents. *SUMA (1999)* argues, "Most of the challenges facing urban municipalities are connected to revenue generation and expenditure management." Understanding the fiscal restraints requires considering the combination of expenditure and revenue pressures. *Kitchen (1997: 135, 164)* writes,

> *"[T]he combination of reduced provincial/territorial grant funding and downloading of various expenditure responsibilities to municipalities has increased pressures on the local revenue base...Over the past few years, the provincial practice of reducing unconditional grants and downloading more and more expenditure responsibilities to local governments has created a fiscal environment in which municipalities are becoming more dependent on local property taxes and user fees. Furthermore, the fiscal reality in which federal and provincial governments currently operate suggests that municipalities will have to become even more self-reliant."*

Perhaps the greatest challenge for municipal governments is to find the means to be self-reliant while maintaining public support. To do so may require a broader reconsideration of the responsibilities and revenue sources for all three orders of government.

CONCLUSIONS

The future path for the financing of Western Canadian cities is unclear, but what is certain is that the matter does require increased public and policymaker attention and research of the available options. Because cities will continue to act as key social hubs and global economic drivers in the years ahead, urban finance issues will grow increasingly important. For cities to ensure that the needs of their residents and their economies are met, they must have access to sufficient and stable revenues. To achieve this, policy debates must move beyond questions of fiscal transfers (how much, conditional versus unconditional) to explore the more fundamental issues of the appropriate forms of revenue generation for cities. Topics that have been raised for research and consideration include providing municipalities access to revenues from sales and fuel taxes, vehicle charges for roadways, reconsidering the role of property tax in the funding of education, and an increased voice for municipalities in provincial decisions that directly impact the cities.

BIBLIOGRAPHY

Alberta Urban Municipalities Association. [illegible]. [illegible]. See [illegible]

Alberta Urban Municipalities Association. [illegible]. "Property Taxes Up for Most Albertans." [illegible]. See [illegible]

Boadway, Robin and Kitchen, Harry. [illegible]. Canadian Tax Policy, Third Edition. Canada: Canadian Tax Foundation.

City of Calgary [illegible]. [illegible]. See www.gov.calgary.ab.ca

City of Edmonton. [illegible]. [illegible]. Presented to City Council June 2, [illegible].

City of Vancouver [illegible]. [illegible]. See [illegible]

City of Vancouver [illegible]. [illegible]. April 21, [illegible]. See [illegible]

Dominion Bond Rating Service. [illegible], dated March [illegible], June 17, [illegible], July 21, [illegible], and December [illegible]. See [illegible]

Federation of Canadian Municipalities. [illegible]. [illegible]. See [illegible]

Kitchen, Harry. [illegible]. "[illegible]" In Paul H.R. Hobson and France St-Hilaire (eds.). [illegible]. Canada: [illegible]. pp. [illegible].

Perry, J. Harvey. [illegible]. Taxation in Canada [illegible]. Canada: Canadian Tax Foundation.

Sancton, Andrew. [illegible]. [illegible]. Canada: [illegible].

Saskatchewan Urban Municipalities Association [illegible]. [illegible]. See [illegible]

Tassonyi, Almos. [illegible]. "[illegible] City-Regions." In Paul H.R. Hobson and France St-Hilaire (eds.). [illegible]. Canada: Institute for Public Policy, pp. 171-[illegible].

Treff, Karin, and Perry, David B. [illegible]. [illegible]. Canada: Canadian Tax Foundation.

Vander Ploeg, Casey, [illegible], and [illegible], Roger. [illegible]. [illegible]. Calgary: Canada West Foundation [illegible].

Vander Ploeg, Casey, [illegible], Glenn, and [illegible], Michael [illegible]. [illegible]. Calgary: Canada West Foundation [illegible].